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TAGS: [ECON](#) [EFIN](#) [RS](#)

SUBJECT: RUSSIA'S ECONOMIC PROGRESSIVES VS. CONSERVATIVES,
ROUND TWO: GROWTH OR STABILITY

REF: A. MOSCOW 937
[1](#)B. MOSCOW 918

Classified By: Acting ECMIN Kathleen Doherty, Reasons 1.4 (b/d).

Summary

[1](#)1. (C) Disagreement between Trade Minister Nabuillina and Finance Minister Kudrin over the right economic prescription - promote growth or control inflation - came into the open at an April 1 conference at the Higher School of Economics. Nabuillina dismissed Kudrin's concern about inflation, calling his inflation-centric focus anachronistic and ineffectual. Kudrin countered that with an overheating Russian economy, greater government spending and a reduction in the value-added tax, as Nabuillina proposed, would exacerbate already double-digit inflation and only marginally help growth. The economically conservative Kudrin seems to have won this round, as he so often has over the past eight years. End Summary.

Background on Disagreements

[1](#)2. (C) Since 2000, the Ministry of Economic Development and Trade (MEDT) and the Finance Ministry have driven economic policy. Led by German Gref until fall 2007, the MEDT has long proposed budget expenditures to spur economic development. MEDT argued that prudent management of the expenditure program from the start would eventually reduce the need for government funding. Armed with a different mandate - keeping inflation in check, rather than focusing on economic growth - Aleksei Kudrin's Finance Ministry opposed many MEDT initiatives. Throughout the past eight years, the Finance Ministry regularly succeeded in controlling budget expenditures, and kept the budget in surplus and inflation, until recently, in check.

Preference for Growth

[1](#)3. (U) During an April 1 conference at the Higher School of Economics on Modernizing Russia's Economy, Economic Trade and Development Minister Nabuillina acknowledged the tension between her ministry's objectives to stimulate economic growth and those of the Finance Ministry to support economic

stability. Measures to grow the economy along with the incoming administration's ambitious goals to forge an innovation economy, modernize the country's health care system, and increase the stock of affordable housing were colliding with rigid fiscal and monetary policy, according to Nabiullina. She lamented that stability had become the country's overriding economic policy priority and asserted that economic growth was Russia's "guarantee" of long-term stability. Consequently, the state needed to support further infrastructure and "human capital" development today or else risk a more feeble, less qualified labor force in the future.

14. (U) Nabiullina summarized her plans to promote greater economic growth: a reduction in the value-added tax (VAT) and the use of GOR resources to support the country's banking sector. Nabiullina endorsed reducing the VAT as a means of kick-starting Russia's innovation economy. A lower VAT, she said, would supply large corporations and small businesses alike with much-needed cash to increase investments in general and in value-added production in particular. She also hailed the GOR resolution signed earlier in the day that allowed temporarily available budget funds to be deposited in commercial bank accounts (Ref A). These funds would help the banking sector "right itself" while liquidity concerns persisted in Russia. Nabiullina also called for the long-term "savings" represented by the Pension Fund and National Welfare Fund to be deposited in commercial banks. These resources would also support the banking sector and provide a reliable source of long-term credit financing for Russia's domestic needs, according to Nabiullina.

Preference for Stability

15. (U) Kudrin observed simply that the economy was overheating. Inflation was close to 5 percent in the first quarter, salary growth was outstripping productivity, and retail consumption was on the rise. Government spending was also up. Outlays in 2007 were up 39 percent over 2006, though only 26.5 percent higher after subtracting budget contributions to new state corporations. Countering Nabiullina, he argued that the GOR had a duty to approach all fiscal policy changes with caution. He said that using public sector resources, such as Pension Fund or National Welfare Fund assets, to promote economic development might, instead, lead to the development of "speculative bubbles." Pointing to Kazakhstan as an example, Kudrin said government financing of the construction industry resulted in a mass of unfinished buildings and defaulted loans. Russia needed to learn this lesson and encourage the private sector to fund development of Russia's version of Nokia, Mercedes, and Siemens.

16. (U) Kudrin also voiced his opposition to a reduction in VAT. The three-year budget, which deposits all oil and gas revenue into the Reserve Fund, formerly the Stabilization Fund, had increased its reliance on VAT revenue. As a result, any decrease in VAT would only serve to increase the budget's deficit, which oil and gas revenues formerly covered. Besides the adverse effect on the budget, Kudrin noted that the increased investment and production resulting from a reduced VAT would not compensate for the measure's inflationary effect on consumer prices.

Comment

17. (C) While Kudrin and Nabiullina, and their Ministries, have largely keep their disputes hidden from the public view, Russia's current growth rate and spiraling inflation have forced this debate into the open. This round, VAT reduction has taken center stage. For the moment, Kudrin seems to have the upper hand in the argument. In light of this dispute, the MEDT has delayed the formal adoption of the GOR's long-term "2020 Vision" planning document, which included a

call to lower the VAT (Ref B).
RUSSELL